

Internal Revenue Service

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Washington, DC 20224

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PLR-139698-06

Date: February 20, 2007

LEGEND

X = .

Date =

State =

Year 1 =

Year 2 =

Year 3 =

Year 4 =

Year 5 =

Dear :

This responds to a letter dated August 17, 2006, submitted on behalf of X, requesting a ruling regarding X's status as an S corporation.

FACTS

The information submitted states that X was incorporated in Year 1 in accordance with the laws of State. X elected to be an S corporation effective Date. X represents that it has only had a single class of stock outstanding since Date. X also represents that, as a matter of State law, all of X's outstanding shares have identical rights to distribution and liquidation proceeds.

Since Year 2, X has made distributions to shareholders that were not in proportion to the shareholders' ownership interests in X. There was no pattern of favoring certain shareholders over others.

X made corrective distributions so that each shareholder would receive a pro rata share of all distributions, but for timing differences. Due to clerical errors, some of the corrective distributions were slightly inaccurate. Amounts paid to redeem certain shareholders between Year 3 and Year 4, which included an amount to correct for past disproportionate distributions, were also slightly inaccurate. X represents that it was not aware that any of these payments would create disproportionate distributions that could potentially jeopardize X's S election.

X discovered the errors in the calculation of its corrective distributions in Year 5. Shortly thereafter, X's board of directors resolved to make corrective distributions to correct for these errors to its current and former shareholders. X will also pay interest on each shareholder's corrective payment.

LAW AND ANALYSIS

Section 1361(a)(1) of the Internal Revenue Code provides that the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for the year.

Section 1361(b)(1)(D) provides that, for purposes of subchapter S, the term "small business corporation" means a domestic corporation that is not an ineligible corporation and that does not, among other things, have more than one class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides that a corporation is generally treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds.

Section 1.1361-1(l)(2)(i) provides that the determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is made based on the corporate charter, articles of incorporation, bylaws, applicable state law, and binding agreements relating to distribution and liquidation proceeds (collectively, the "governing provisions"). Although a corporation is not treated as having more than one class of stock so long as the governing provisions provide for identical distribution and liquidation rights, any distributions (including actual, constructive, or deemed distributions) that differ in timing or amount are to be given appropriate tax effect in accordance with the facts and circumstances.

Section 1362(d)(2)(A) provides that an election under § 1362(a) will be terminated whenever (at any time on or after the first day of the first taxable year for which the

corporation is an S corporation) such corporation ceases to be a small business corporation. Section 1362(d)(2)(B) provides that the termination shall be effective on and after the date of cessation.

Section 1362(f) provides that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3), (2) the Secretary determines that the circumstances resulting in such termination were inadvertent, (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation is a small business corporation, and (4) the corporation, and each person who was a shareholder in the corporation at any time during the period specified pursuant to § 1362(f), agrees to make such adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to such period, then, notwithstanding the circumstances resulting in termination, such corporation shall be treated as an S corporation during the period specified by the Secretary.

CONCLUSION

Based solely on the information submitted and the representations made, we conclude that it is not clear on these facts whether there was a termination of X's S election. However, we conclude that, if X's S election was terminated, such termination was inadvertent within the meaning of § 1362(f). Therefore, we rule that X will be treated as continuing to be an S corporation from Date, and thereafter, provided that X's S election is not otherwise terminated under § 1362(d). This ruling is contingent upon X making the corrective distributions within 60 days of the date of this letter. X's shareholders, in determining their respective income tax liabilities during the termination period and thereafter, must include their pro rata share of the separately stated computed items of income or loss of X as provided in § 1366, make any adjustments to basis provided in § 1367, and take into account any distributions made by X as provided in § 1368.

Except as expressly provided herein, no opinion is expressed or implied concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, no opinion is expressed or implied as to whether X otherwise qualifies as an S corporation under § 1361.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

David R. Haglund
Senior Technician Reviewer, Branch 1
Office of the Associate Chief Counsel
(Passthroughs & Special Industries)